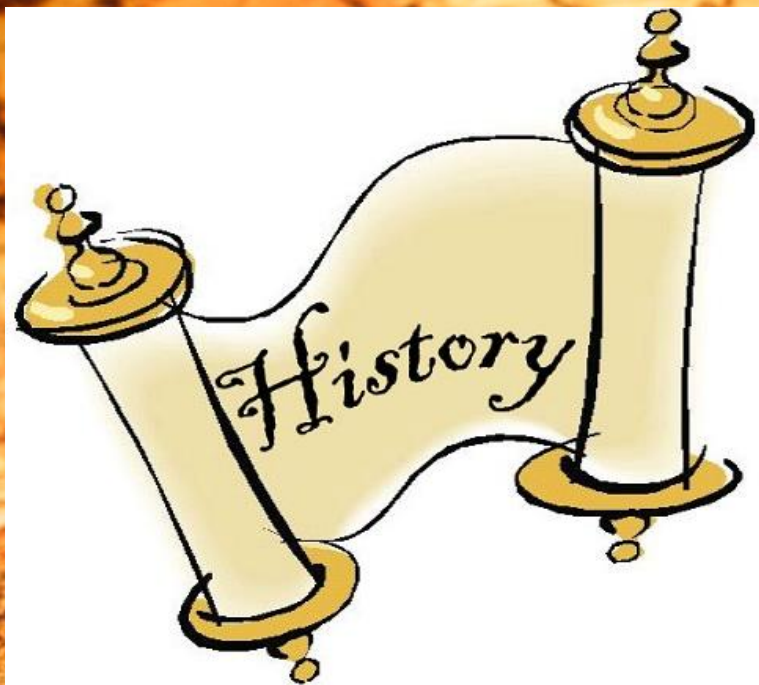


*the
life-changing magic of
grantor trusts*

**Samuel A. Donaldson
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Our Agenda

- History of the Grantor Trust Rules
- When to Use (and Not to Use) a Grantor Trust
- Third-Party Grantor Trusts
- Choosing the Right Powers for Grantor Trust Status
- Drafting Issues with Grantor Trusts
- Fun and Games with Grantor Trusts
- Income Tax Reporting





1954 Taxable Income Exceeding		
Single	Married	Ordinary Income Tax Rate
\$0	\$0	20%
\$2,000	\$4,000	22%
\$4,000	\$8,000	26%
\$6,000	\$12,000	30%
\$8,000	\$16,000	34%
\$10,000	\$20,000	38%
\$12,000	\$24,000	43%
\$14,000	\$28,000	47%
\$16,000	\$32,000	50%
\$18,000	\$36,000	53%
\$20,000	\$40,000	56%
\$22,000	\$44,000	59%
\$26,000	\$52,000	62%
\$32,000	\$64,000	65%
\$38,000	\$76,000	69%
\$44,000	\$88,000	72%
\$50,000	\$100,000	75%
\$60,000	\$120,000	78%
\$70,000	\$140,000	81%
\$80,000	\$160,000	84%
\$90,000	\$180,000	87%
\$100,000	\$200,000	89%
\$150,000	\$300,000	90%
\$200,000	\$400,000	91%

A ginger and white cat is lying on its back on a grey couch, looking directly at the camera. A blue thought bubble is positioned to the right of the cat's head, containing text. The cat has orange fur with white patches on its chest, belly, and paws.

**Put income-
producing assets
in trusts to save
federal income
tax!**

Subchapter J – Estates, Trusts, Beneficiaries, and Decedents

Part I – Estates, Trusts, and Beneficiaries

SUBPART E – GRANTORS AND OTHERS TREATED AS SUBSTANTIAL OWNERS

Section 671 – Trust income, deduction, and credits attributable to grantors and others as substantial owners

Section 672 – Definitions and rules

Section 673 – Reversionary interests

Section 674 – Power to control beneficial enjoyment

Section 675 – Administrative powers

Section 676 – Power to revoke

Section 677 – Income for benefit of grantor

Section 678 – Person other than grantor treated as substantial owner

Section 679 – Foreign Trusts having one or more United State beneficiaries



Oh no!

2020 Taxable Income Exceeding			
Single	Married	Trust / Estate	Ordinary Income Tax Rate
\$0	\$0	\$0	10%
\$9,875	\$19,750		12%
\$40,125	\$80,250		22%
\$85,525	\$171,050	\$2,600	24%
\$163,300	\$326,600		32%
\$207,350	\$414,700	\$9,450	35%
\$518,400	\$622,050	\$13,150	37%

2020 Taxable Income Exceeding			
Single	Married	Trust / Estate	Cap Gain Tax Rate
\$0	\$0	\$0	0%
\$40,000	\$80,000	\$2,650	15%
AGI > \$200,000	AGI > \$250,000		18.8%
\$441,450	\$496,600	\$13,150	23.8%



...
Hmm. Maybe
I *want* a
grantor trust!



Do I want a grantor trust?

- 1. Pay less federal income tax
- 2. Allow for later transactions with the trust



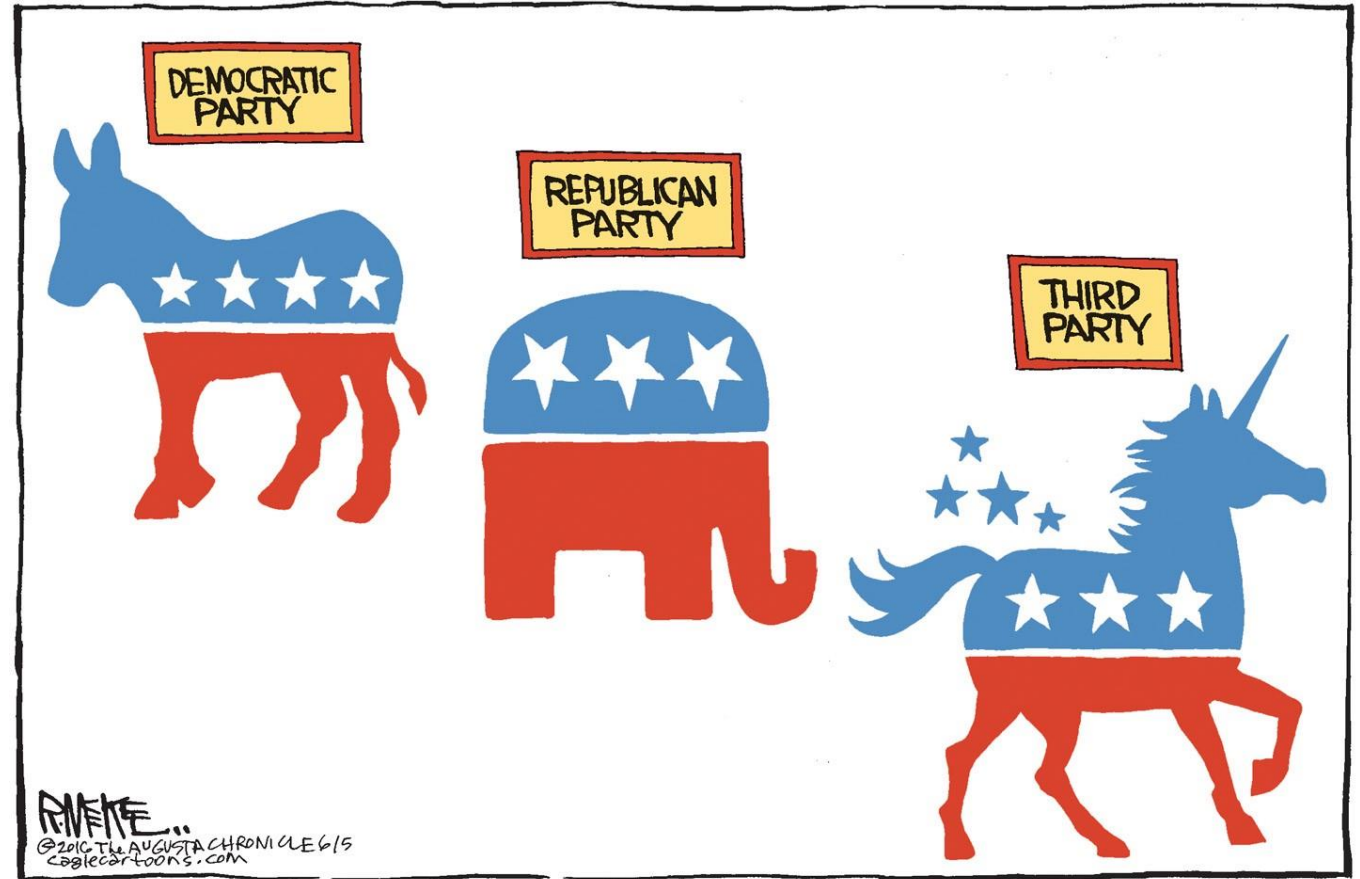
- 1. Defer / avoid state income tax
- 2. Maximize certain deductions (§199A, state and local taxes, tax prep fees, charitable contributions)

Third-Party Grantor Trusts

Imputing ownership to someone other than the grantor

Section 678 Trusts, aka
sometimes as “Beneficiary
Deemed-Owner Trusts”
(BDOTs)

Section 679 Trusts, aka
“Foreign Grantor Trusts”

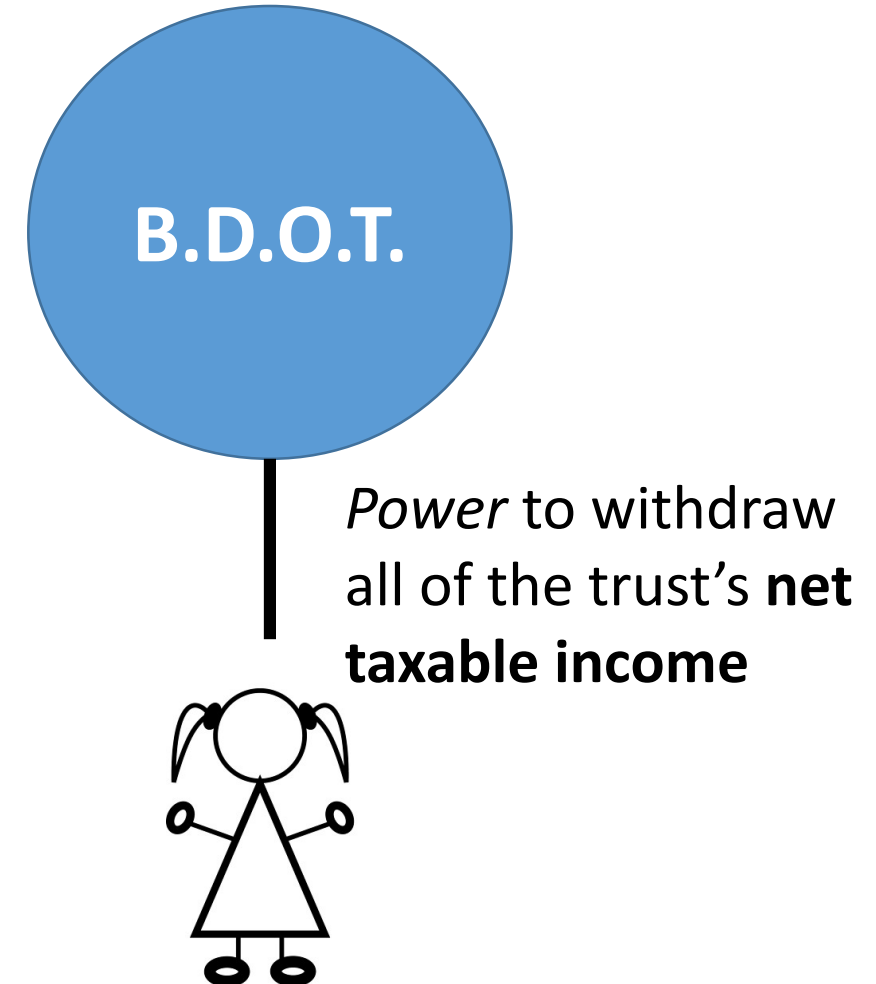


Section 678 Trusts

Beneficiary Deemed-Owned Trusts (BDOTs)

Section 678(a) **GENERAL RULE** A person other than the grantor shall be treated as the owner of any portion of a trust with respect to which:

- (1) such person has a power exercisable solely by himself to vest the corpus or the income therefrom in himself, or
- (2) such person has previously partially released or otherwise modified such a power and after the release or modification retains such control as would, within the principles of sections 671 to 677, inclusive, subject a grantor of a trust to treatment as the owner thereof.



Section 679 Trusts

Foreign Grantor Trusts



United States person

**Treated as owner of
gifted property**

Property

**May be taxable
if Trust is
separate entity**

**Foreign
Trust**



United States beneficiary

**HOW
TO**

A 3D graphic of the words "HOW TO" in a bold, sans-serif font. The letters are white with a thick red outline and are rendered with a strong three-dimensional effect, casting shadows on a white surface below. The "H" and "T" are positioned on the left, while the "O"s and "W" are on the right, creating a dynamic, slightly staggered layout.

Powers that **DON'T** result in a Grantor Trust

GROSS ESTATE INCLUSION

- Testamentary power to control **distributions**
- Power to **appoint** income or principal to a **charity** of the grantor's choice
- Power to **control timing** of distributions

NO GROSS ESTATE INCLUSION

- Mere **administrative power**
- Power to distribute limited by an **ascertainable standard**
- Power to **withhold** income during **minority** or **disability**
- Independent trustee power to distribute (unless G can replace)

STEPPED-UP BASIS!

Grantor Trust Powers

“DEFECTIVE” GRANTOR TRUST



GROSS ESTATE INCLUSION

- Most **reversions**
- Most **powers to control distributions** during grantor's life
- **Testamentary power** to appoint **accumulated income**
- Grantor **power to deal** trust property for **less than full consideration**
- Grantor **power to vote to controlled corp. stock** in non-fiduciary capacity
- Retained **right to income**

NO GROSS ESTATE INCLUSION

- LOAN POWER
- ACTUAL LOAN(S)
- POWER TO ADD CHARITABLE BENEFICIARY
- SWAP POWER
- Nonadverse party **power to deal** trust property for **less than full consideration**
- Third-party nonfiduciary **power to vote stock** or control stock investments



STEPPED-UP BASIS!

Creating Defective Grantor Trusts

- LOAN POWER

- Power held by **Grantor** or **Nonadverse Party**
- Enabling Grantor to borrow on **unsecured basis**
- Expressly contained in trust instrument

- ACTUAL LOANS

- **Grantor** or **Grantor's Spouse** has actually borrowed from the trust
- On an **unsecured basis**
- Not repaid on the first day of the taxable year
- Trustee is not Grantor, Spouse, or a Related / Subordinate Party



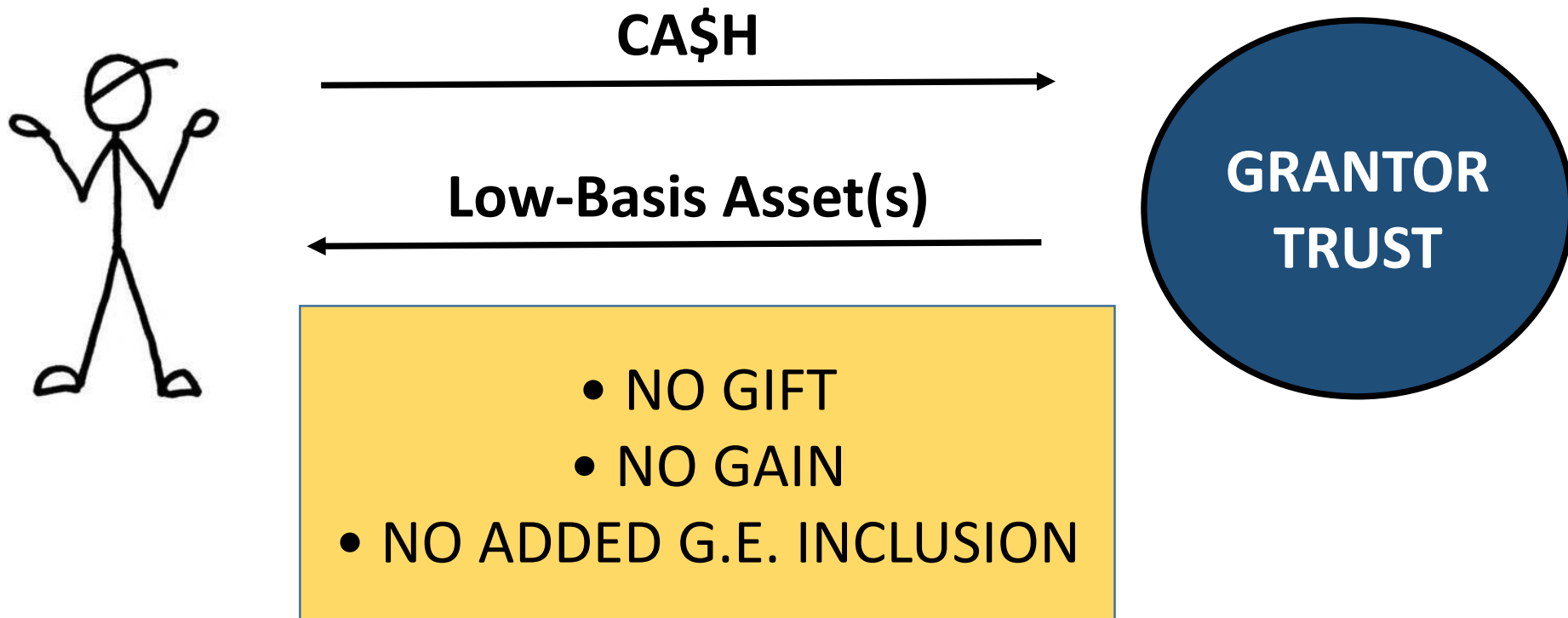
Creating Defective Grantor Trusts

- POWER TO ADD CHARITABLE BENEFICIARY
 - Power held by **anyone other than Grantor**
 - To add 1+ **charities** as beneficiaries
 - **Without consent** of an Adverse Party
- SWAP POWER
 - Power held by **anyone**
 - Exercisable in a **nonfiduciary capacity**
 - To **reacquire** trust property by **substituting property of equivalent value**



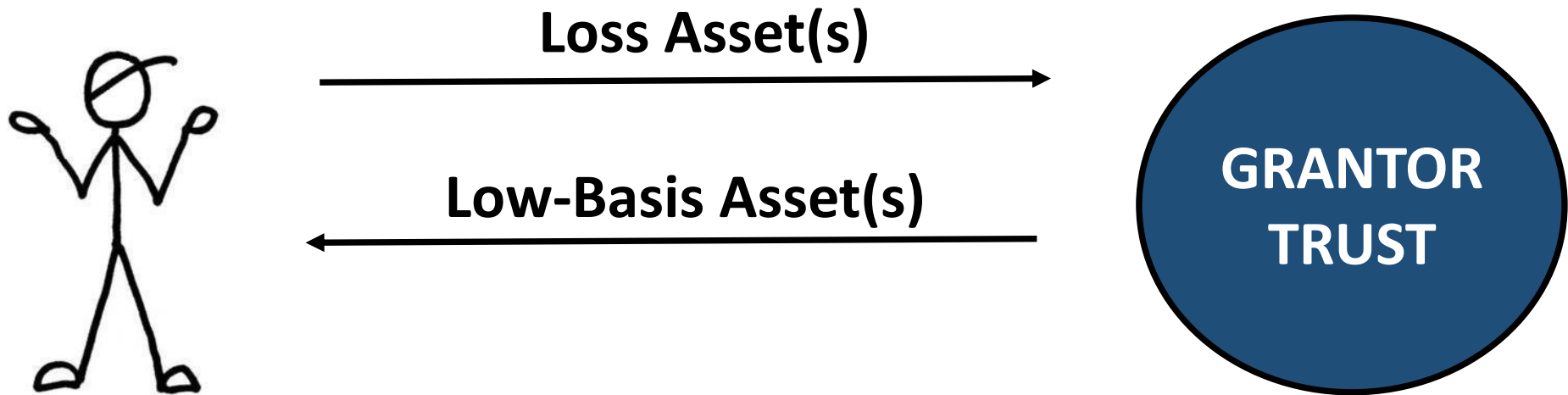
Exercise Swap Powers!

(1) LEVERAGE THE STEP-UP IN BASIS



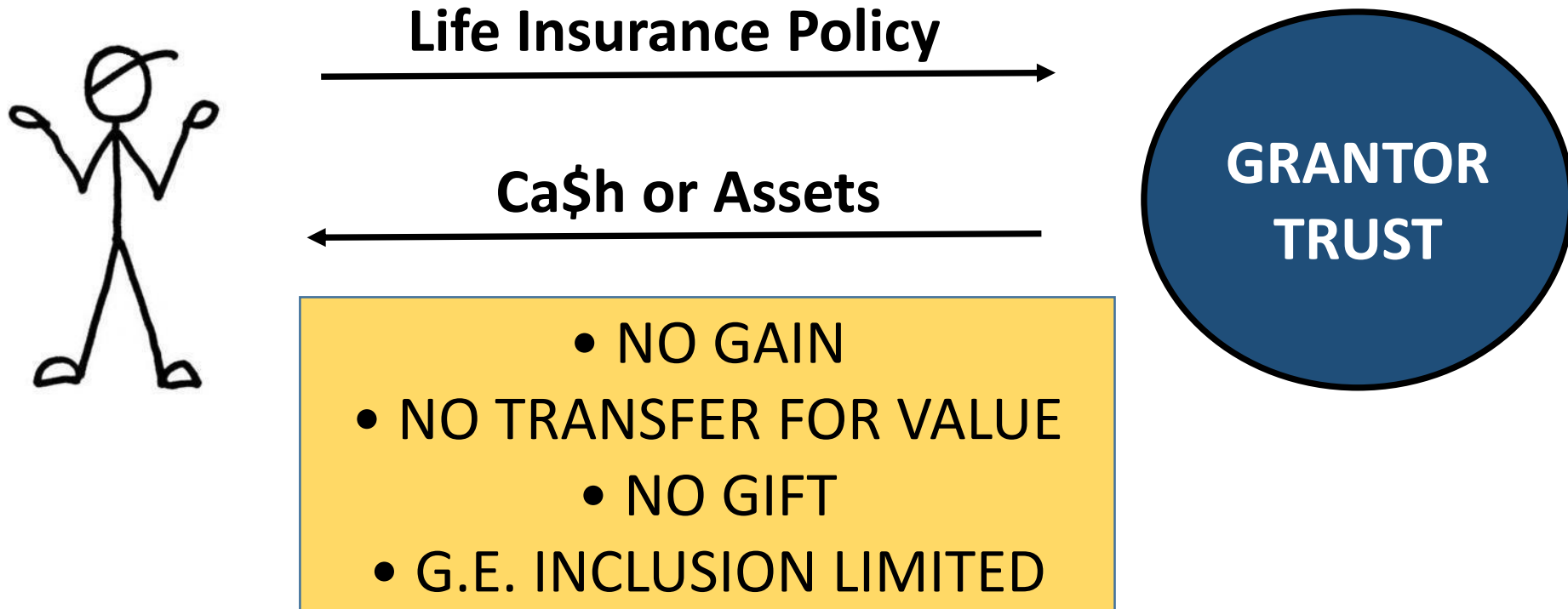
Exercise Swap Powers!

(2) PRESERVE LOSSES



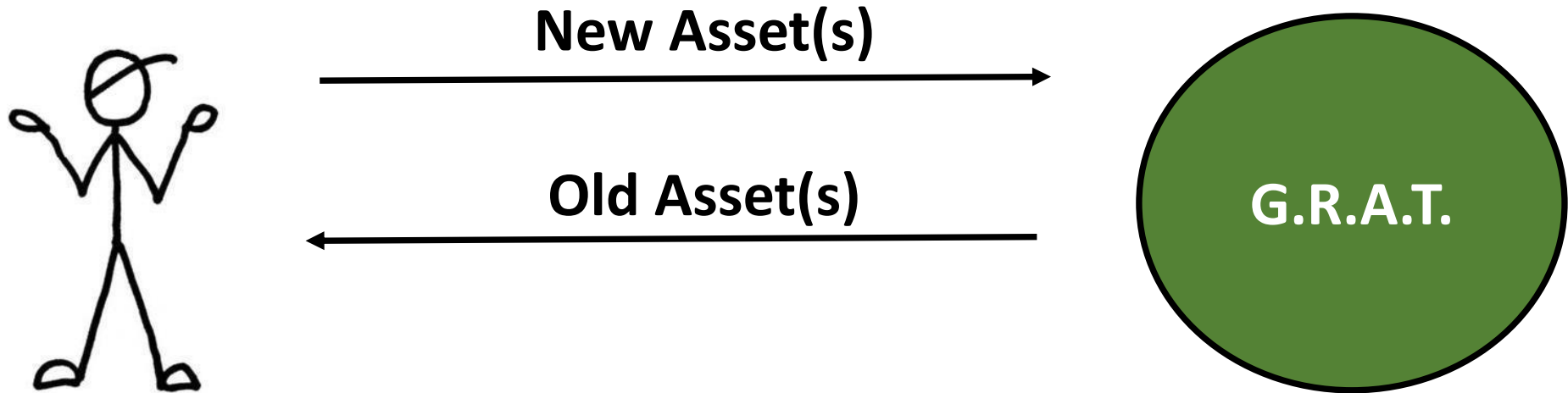
Exercise Swap Powers!

(3) ELUDE THE 3-YEAR RULE



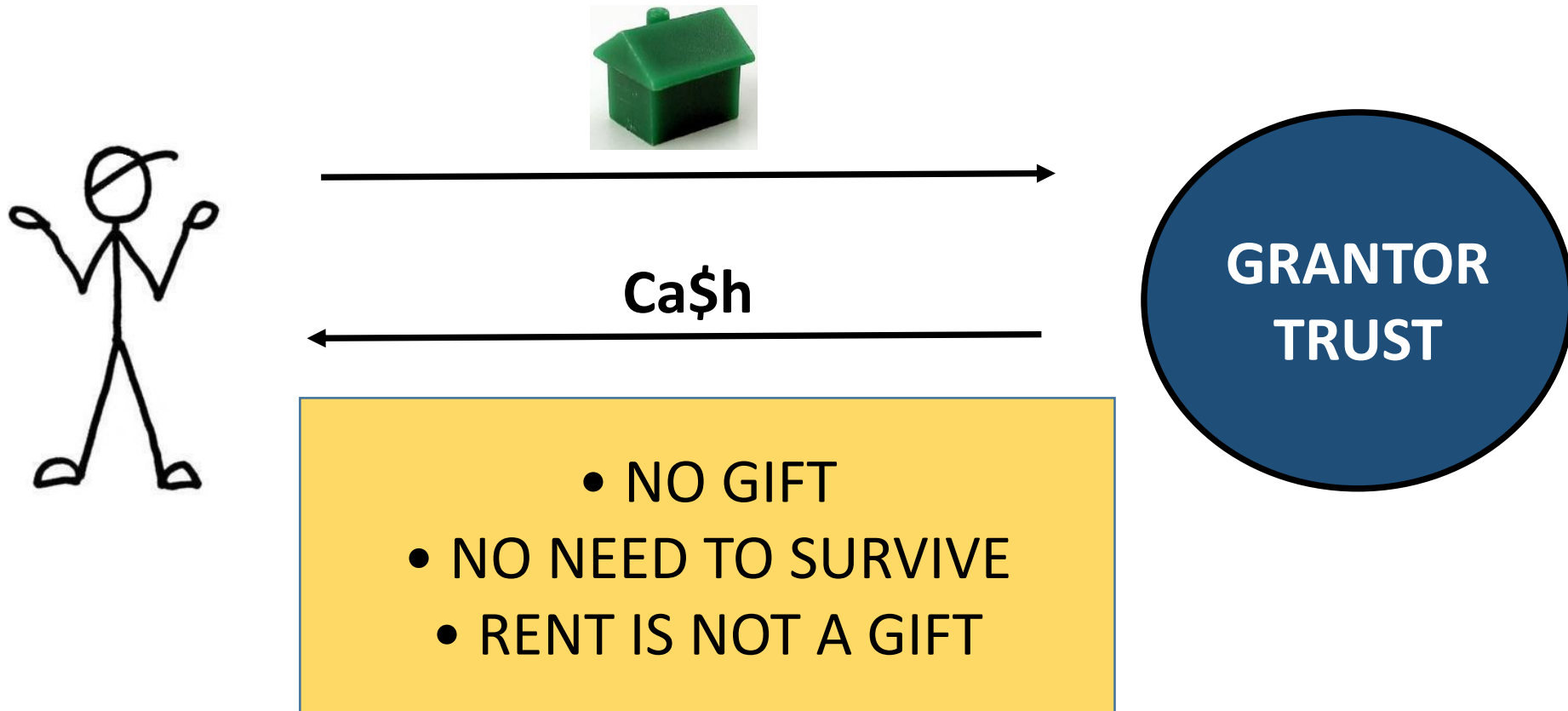
Exercise Swap Powers!

(4) CONTROL CASH FLOW



Exercise Swap Powers!

(5) TAX-FREE Q.P.R.T.

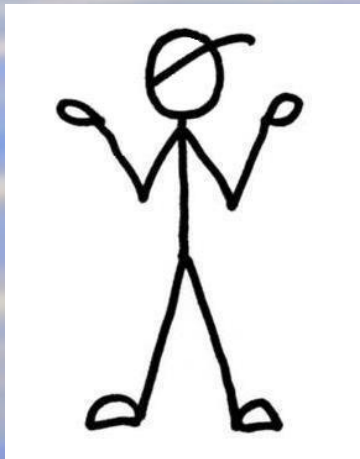




Swap Power

**Other Grantor
Trust Power**

Beware the Swap!



High-Basis Asset(s)



Low-Basis Asset(s)



**GRANTOR
TRUST**

Drafting Issues

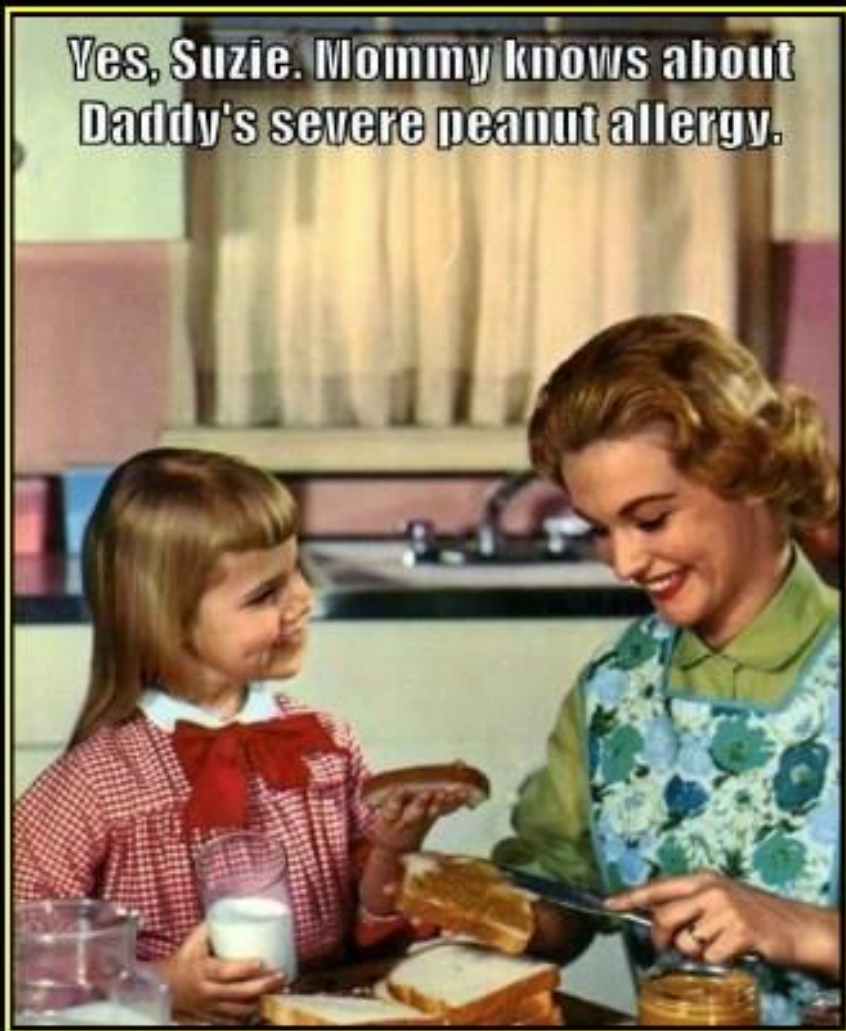
A person with blonde hair in a ponytail, wearing a grey shirt, is drafting architectural plans. They are using a yellow pencil and a metal ruler on a large sheet of paper. A black and yellow compass is visible on the left side of the paper. The plans include various lines, dimensions, and a circular detail. The background is slightly blurred, showing the person's head and shoulders.

- *Crummey* Powers
- Life Insurance as a Trust Asset
- Tax Reimbursement Clause
- Toggling Grantor Trust Status

Should I give grantor trust beneficiaries a “*Crummey* Power”?



- **Revenue Ruling 81-6**: A *Crummey* power renders the beneficiary taxable under §678(a).
- **Regulation §1.671-3(a)(3)**: Beneficiary taxed on a fractional share of the trust's income.
- **Section 678(b)**: Section 678(a) does not apply “with respect to a power over income ... if the grantor of the trust ... is otherwise treated as the owner [for income tax purposes].”



Life Insurance as a Grantor Trust Asset

- An irrevocable life insurance trust (ILIT) is a grantor trust where income may be used to pay policy premiums [**§677(a)(3)**]
- **Revenue Ruling 2011-28** = a swap power is not an “incident of ownership” that will cause the policy death benefit to be included in the grantor’s gross estate
- **Revenue Ruling 2007-13** = transfer of policy from one grantor trust to another is not a “transfer for value” for income tax purposes

**AND HIS LIFE
INSURANCE, TOO**

Tax Reimbursement Clauses



- **Revenue Ruling 2004-64** generally favorable
 - Grantor's payment of tax on trust income NOT a gift to the beneficiaries
 - Discretionary tax reimbursement clause does not cause gross estate inclusion and is not a deemed gift from the beneficiaries (assuming no understanding that trustee will exercise discretion in grantor's favor)
 - Mandatory tax reimbursement clause DOES cause gross estate inclusion under §2036(a)(1)
- But be careful here too!
 - Generally better for Grantor to pay tax instead of trust
 - Potential creditor problems

Toggling Grantor Trust Status



- TURNING GRANTOR TRUST STATUS “ON”
 - Springing power
 - Power conferred by trust protector
 - Actual loans to grantor / grantor’s spouse
- TURNING GRANTOR TRUST STATUS “OFF”
 - Renounce power
 - Decant to a nongrantor trust

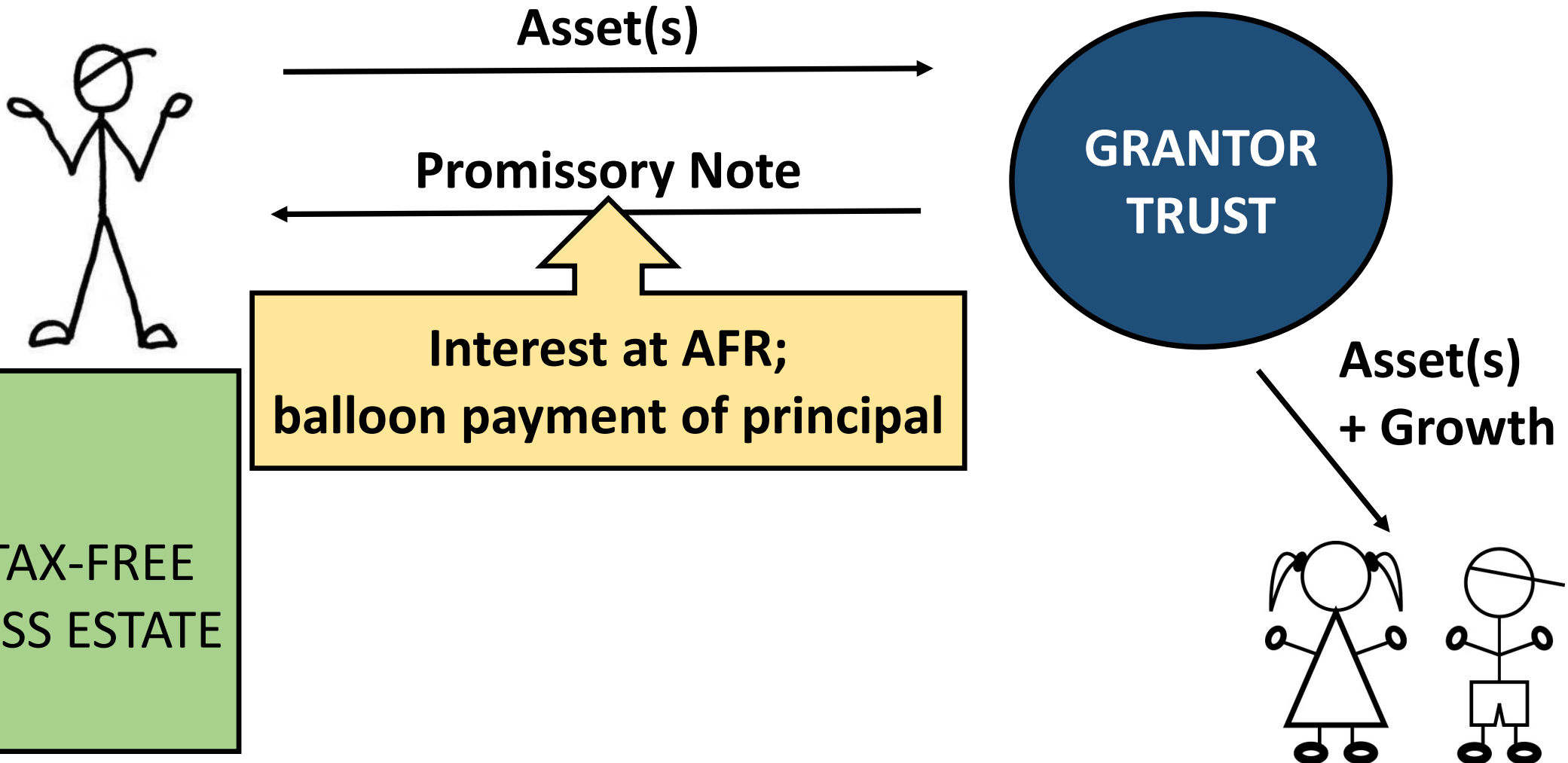


Installment Sale Transactions

Spousal Grantor Trust Sales

Grantor-Retained Annuity Trusts (GRATs)

Installment Sale Transactions



- NO GIFT
- NO GAIN
- INTEREST TAX-FREE
- FIXED GROSS ESTATE INCLUSION

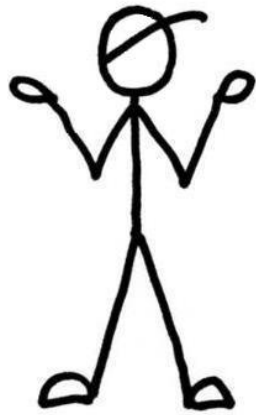
Installment Sale Transactions

I will not ask dumb questions
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- (1) Do I **disclose** the sale transaction on a gift tax return?
- (2) What happens if the **grantor dies** before the note has been repaid?
- (3) What is the **trust's basis** in the property purchased from the grantor?

Spousal Grantor Trust Sales



Asset(s)

Promissory Note

Interest at AFR;
balloon payment of principal

**SPOUSE'S
GRANTOR
TRUST**

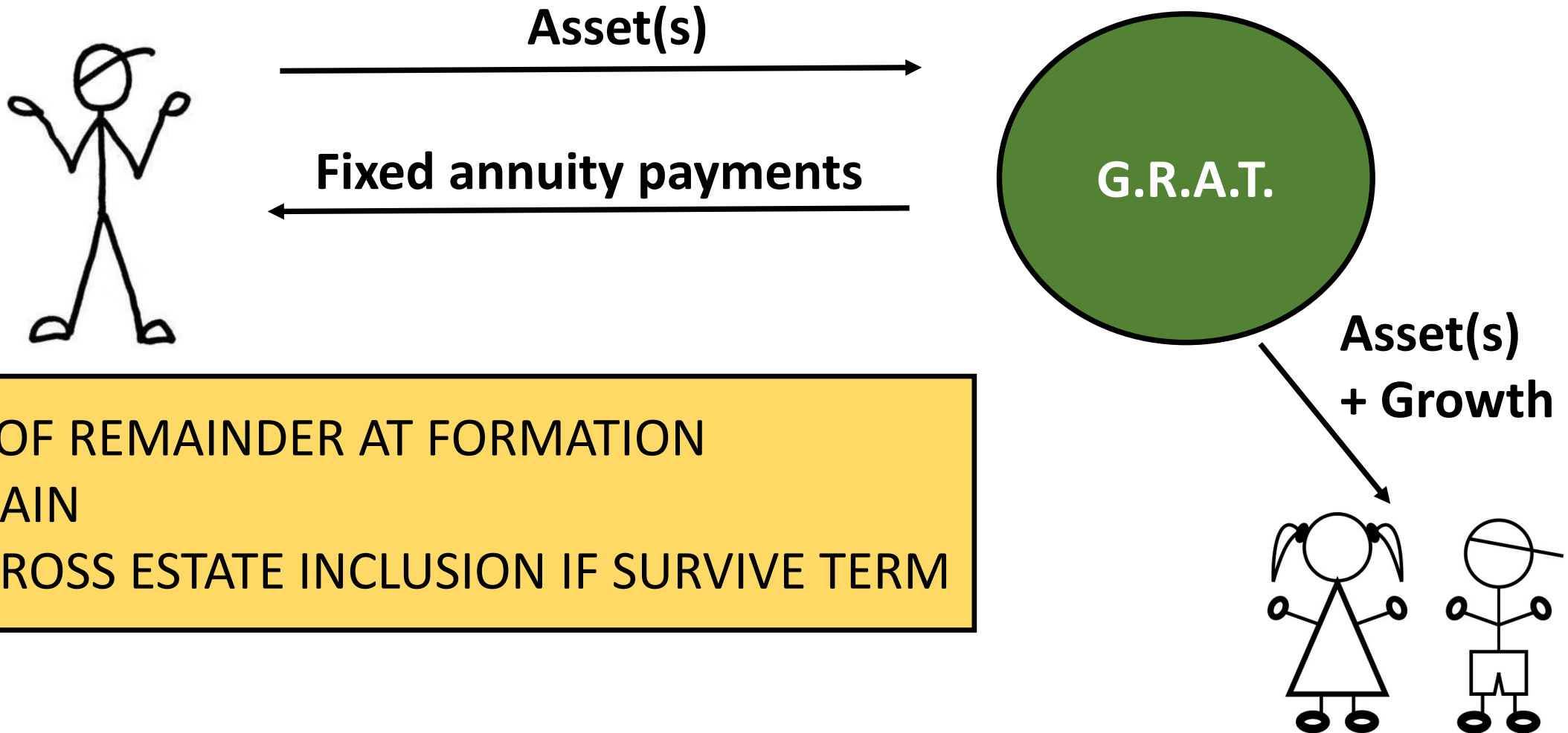


**Trustee /
Beneficiary**

- NO GIFT
- NO GAIN [§1041]

- INTEREST TAXABLE?
- GROSS ESTATE INCLUSION?

GRATs



- GIFT OF REMAINDER AT FORMATION
- NO GAIN
- NO GROSS ESTATE INCLUSION IF SURVIVE TERM

Income Tax Reporting



Three Options to Report Grantor Trust Income



- **THE 1041 METHOD**

- Trust files (and gives grantor) blank Form 1041 with trust tax items attached on separate statement

- **THE W-9 METHOD**

- Grantor gives Form W-9 to trustee who forwards it to all trust payors

- **THE 1099 METHOD**

- Trustee files Forms 1099 for all payments listing trust as payor and grantor as payee

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